

EMPLOYEE OR SHAREHOLDER OR BOTH?

In a recent case the Court of Appeal has held that there is no reason in principle why a director and controlling shareholder cannot also be an employee, even if they had total control of the company. Clare Waller, a Director at HRJ Law LLP, discusses the implications.

It has been generally accepted that directors can be employees. However, until recently there has been conflicting legal authority about whether or not a controlling shareholder could qualify as an employee. This issue has now been clarified by the English Court of Appeal.

In *Secretary of State for Business, Enterprise and Regulatory Reform v Neufeld* the Court of Appeal held that two controlling shareholders were also employees. This decision also means that directors and shareholders who qualify as “employees” are eligible to claim payments such as statutory redundancy payments and unpaid wages from the National Insurance Fund if a company becomes insolvent. The issue in this appeal was of importance given the current number of insolvencies and the consequential claims by directors for payment from the NIF - there were around 12,000 in 2008, and the figure is expected to increase for 2009.

The Court of Appeal set out new guidance for tribunals and in doing so it expressly rejected the previous view that an individual could not be an employee if they were the controlling shareholder of a company. It also held that, in the event of an insolvency, the question of employment status had to be determined at the date when the company became insolvent.



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Lord Justice Rimer, said the court had first to determine whether or not the putative contract was a genuine contract. The second issue was whether, assuming the contract was genuine, it amounted to a contract of employment rather than a contract for services.

Sham contracts would almost invariably be in writing. There would need to be an investigation into the circumstances of the creation of the formal employment contract or board minute.

The court would also have to determine whether or not the parties had acted in accordance with the contract. The court would need to be convinced that the contract was in force at the time of the insolvency.

In light of the above case it is increasingly important to identify whether it could be argued that a true contract of employment between a company and its director(s) and/or shareholders(s) exists since this will effect the individual in question's entitlements, and the procedures that must be followed when carrying out processes such as redundancies, dismissals and transfers. The court will not necessarily accept a document which appears to be a contract of employment if it is not satisfied that the document represents the true relationship between the parties.